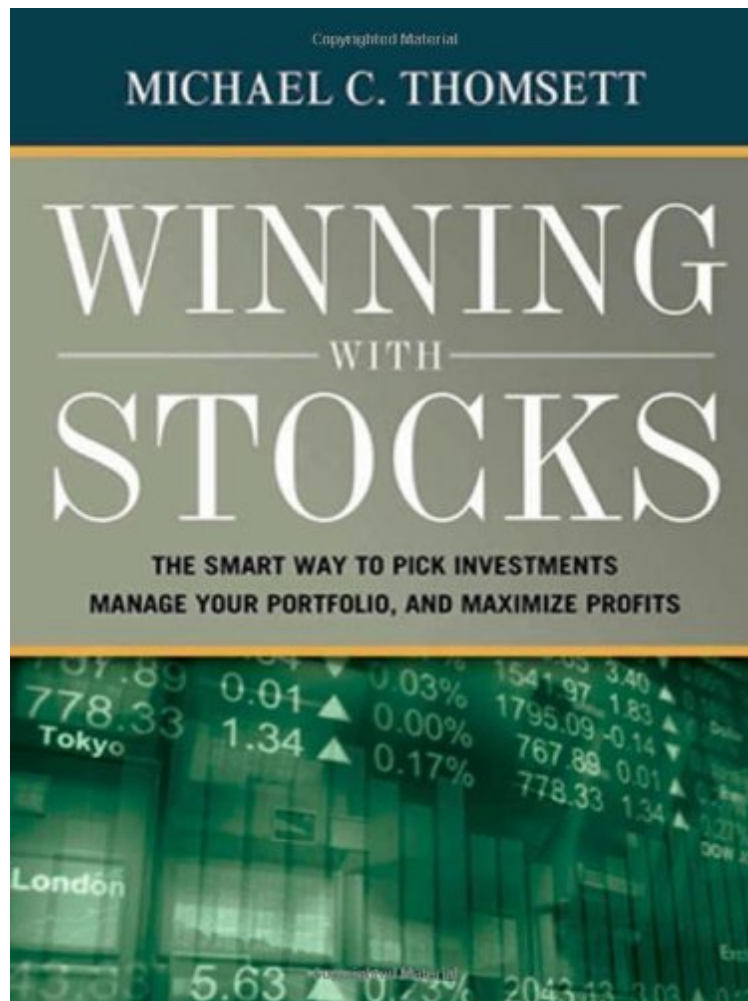


[Mobile ebook] Winning With Stocks: The Smart Way to Pick Investments, Manage Your Portfolio, and Maximize Profits

# Winning With Stocks: The Smart Way to Pick Investments, Manage Your Portfolio, and Maximize Profits

Michael C. Thomsett

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**Michael C. Thomsett : Winning With Stocks: The Smart Way to Pick Investments, Manage Your Portfolio, and Maximize Profits** before purchasing it in order to gage whether or not it would be worth my time, and all praised Winning With Stocks: The Smart Way to Pick Investments, Manage Your Portfolio, and Maximize Profits:

With a refreshing absence of jargon - and a substantial dose of straightforward guidance and explanation - "Winning with Stocks" breaks down the basics of making the kind of investment decisions that will pay off. Covering the most valuable indicators of stock market performance - such as current ratio and debt ratio, revenue trend, net return, price history, volatility, P/E ratio, and trading range trends - the book shows readers how to take advantage of opportunities

while limiting risks. Readers will learn how to uncover the best stocks, determine what to believe in the popular press, manage liquidity, employ technical tests to analyze companies' performance, and more. Supplying practical tools and illuminating examples, the book gives readers the guidance and information they need to control their individual portfolios, take control of their investments, and maximize their long-term success in the ever changing market.

About the Author Michael C. Thomsett (Port Townsend, WA) has written more than 70 books, including *Winning with Options* (978-0-8144-0033-3), *Annual Reports 101* (978-0-8144-7367-2), *The Stock Investor's Pocket Calculator* (978-0-8144-7460-0), *Getting Started in Options*, and *Getting Started in Fundamental Analysis*. He has been a management consultant in the securities industry and is an active stock trader. Excerpt. copy; Reprinted by permission. All rights reserved.

### CHAPTER 1 A SHORT HISTORY OF THE STOCK MARKET

The stock market is a fascinating cultural and financial place with a rich history. Before the telephone, communication was virtually impossible beyond the walls of the exchange or, in the case of the American Stock Exchange (AMEX), out on the street, because the exchange could not afford a building, thus its nickname, "the curb." In those days, the Philadelphia Stock Exchange (PHX) was at great disadvantage because traders in New York knew days ahead of others what goods were arriving by ship. So the PHX set up a series of men on hills with mirrors and telescopes, and messages were conveyed from New York to Philadelphia in less than one hour. Because trading in the old days was limited to the exchange, only brokers and dealers were able to trade; the market simply was not available to the average person, an idea that is unthinkable today. Major advances included the telegraph, ticker tape, telephone, and of course, the computer. All of these changes have vastly improved the ability of people to communicate and to trade. This chapter introduces you to many of the most common errors investors make; by knowing these you are better equipped to avoid falling into the common market traps. This is followed by a brief history of the market itself, which is not only fascinating and interesting, but also demonstrates how we arrived at the system we have today. The modern market is cheap, efficient, and well regulated. Today, more than ever before, the market has become truly democratic. Anyone with a few hundred dollars can buy shares of any listed company through a free online brokerage account, pay little or nothing for opening that account, and trade for only a few dollars. You no longer need to rely on expensive stockbrokers offering advice you really don't need. You can find your own research through books, the Internet, investment clubs, and association membership. In today's market, anyone willing to research for themselves and to study the market has a better chance than ever before to create and manage a stock portfolio. Even so, caveat emptor continues to apply in the stock market as it does elsewhere. You cannot trust other people to make decisions for you, tell you where to invest, or ensure profitability. One reason for studying the long history of the market is to come to an understanding of the many problems inherent in any venue where a lot of money changes hands. Greed dominates the market, and that fact is unavoidable. The market attracts not only millions of honest, hardworking people who want to build security for themselves and their families, but also a variety of con artists and outright thieves. Unfortunately, many of these "market lowlives" exist and thrive among all of us and often function as advisers, financial planners, analysts, stockbrokers, and online marketing companies offering "free" advice on how to get rich—they are everywhere. The experience most people are going to have in the market will be largely positive, based not on any assurance of safety by government regulators, but by the simple fact that everyone is in control of their own destiny. This includes your portfolio. If you are realistic, willing to work and learn how the market functions, and you understand that profit potential always comes with risk, there is nothing to prevent you from enjoying the amazing "freedom to invest and profit" that you can have in the U.S. stock market.

#### A Starting Point: Avoiding the Mistakes of the Past

A history usually begins at the oldest point and moves forward. Before going back in time, however, it makes sense to begin at the end to expose the most common errors people make when they invest in the stock market. Knowing the history of the market is valuable and important, but even before you read about that, it is equally important to know what mistakes other people often make. History repeats itself. Everyone has heard this before, and it makes sense to know that most people are prone to fall into the same traps as those who have gone before. Thus, studying common errors is valuable intelligence, because it helps you to avoid those same problems. One cynical point of view about this was expressed by George Bernard Shaw, who mused, "If history repeats itself, and the unexpected always happens, how incapable must Man be of learning from experience." This point of view is actually quite common in the market, but it is fatalistic and assumes that no one can overcome the errors of the past. If this is true, then you might as well turn over your money to a mutual fund and hope that its management is better than average. Contrary to that cynical point of view, it is possible for hardworking people to make informed decisions and to beat market averages, simply by observing (a) what others have done to lose money, (b) the mistakes that recur in the market, and (c) how specific indicators do, in fact, lead you to profits consistently. Among the mistakes investors make are eight of the most important, listed below and also summarized in Table 1-1.

#### Mistake #1: Investing with More Risk Than You Can Afford

Risk—the chance that you will lose rather than gain—is an inherent attribute in all investments; there are no risk-free investments. A fully insured, guaranteed savings account contains the risk that income will not beat the combination of inflation and taxes, so even that represents a specific risk. In the stock market, risk usually refers to market risk, or the risk associated specifically with the price per share of stock. If you buy 100

shares at \$50 per share and pay \$5,000 and the stock's market value then falls to \$45, you lose \$500. A worthwhile exercise is to begin by defining your risk tolerance, or your ability to take risks and to afford possible losses. Stock risk is often spotted by way of volatility, the tendency for prices to move around. High-volatility stocks are often erratic and have a broad trading range, and low-volatility stocks tend to trade within a narrower price range. Once you have identified what you can afford in terms of risk, it is easier to match your risk tolerance to companies whose stock histories are a good fit. Many people—including those who define their risk tolerance in advance—invest in inappropriate ways, taking risks they cannot afford. This is perhaps the most common mistake investors make. For example, many investors define themselves as conservative and "in it for the long term," and then trade like speculators.

**Mistake #2: Chasing Income but Forgetting Cash Flow** The emphasis of income in the market is easy to understand. Everyone wants to buy bargain-priced stocks and cash in on a big price run-up. To a lesser degree, dividends are also a form of income but the dividend rate is at times overlooked. Investors tend to focus exclusively on profit potential but overlook the equally important cash flow, or the availability of cash when you need it. For example, if you invest in stock that does not go up in value, you might determine that you need to keep your money tied up for several months. This might be especially true in cyclical stocks, whose economic cycle is tied to the calendar or to the economy. However, if it turns out that you need those funds before the cycle goes into an uptrend, you have to sell shares at a loss. This cash flow risk means that you cannot afford to hold onto positions as long as necessary to create profits. Because you have to take out funds for other purposes, the timing is poor for some of those long-term investments.

**Mistake #3: Limiting Your Investing Horizon** It is easy to become myopic in the stock market. Once you find something that works, the tendency is to stick with it. For example, if you buy shares of an energy company and make a profit, you might believe that this sector is a "sure thing." But if your timing is poor, that does not necessarily apply. This is why most people suggest that you diversify your investment capital among several different stocks, sectors, and markets. These different markets may include non-stock areas like bond mutual funds, real estate, options and futures, or precious metals. You can also diversify by buying shares of equity mutual funds or exchange-traded funds (ETFs). Effective diversification protects you from a broad overall loss due to a failure in a single company or sector. Those whose investing horizon is limited tend to be close-minded to the concept of diversification, so they are at greater risk. As long as investment capital remains in too few stocks or markets, the risk remains. The more capital focused in singular stocks or sectors, the greater the risk.